Thornock v. Commissioner, 94 T. C. 439 (1990)

Limited partners in leveraged leasing transactions are not considered at risk under Section 465 if protected against economic loss by guarantees and nonrecourse financing.

Summary

Russell Thornock invested in Tiger Lily Leasing Associates, a partnership engaged in a highly leveraged computer equipment leasing transaction. The court held that Thornock was not at risk under Section 465 of the Internal Revenue Code because the partnership's debt obligations were protected by guarantees from related entities, and the underlying loan was nonrecourse. This protection against economic loss meant that Thornock could not claim the partnership's losses and expenses as deductions on his tax returns. The decision underscores the importance of examining the substance over the form of financial arrangements in determining at-risk status.

Facts

Russell Thornock invested $10,000 in Tiger Lily Leasing Associates, which purchased computer equipment from Alafund Associates and leased it back to A-F Associates. The purchase was financed through a nonrecourse loan from Citicorp Credit to Alanthus Computer, which sold the equipment to A-F Associates and then to Alafund Associates. Tiger Lily's debt to Alafund Associates was nominally recourse to the limited partners, but Alanthus and Alafund Associates guaranteed A-F Associates' lease payments to Tiger Lily, effectively protecting the limited partners from economic loss. The transaction structure included offsetting lease and note payments and a "user rent achievement date" that would extinguish the limited partners' liability.

Procedural History

The IRS disallowed Thornock's claimed deductions from Tiger Lily's losses and expenses. Thornock petitioned the U. S. Tax Court for review. Both parties filed cross-motions for partial summary judgment, which the court granted in favor of the Commissioner, holding that Thornock was not at risk under Section 465.

Issue(s)

1. Whether Thornock was at risk under Section 465 with respect to Tiger Lily's debt obligations.

Holding

1. No, because the guarantees by Alanthus and Alafund Associates, combined with the nonrecourse nature of the underlying loan and the offsetting nature of the lease

© 2025 SCOTUSreports.com. All rights reserved.

and note payments, protected Thornock from any realistic economic liability on the partnership debt.

Court’s Reasoning

The court analyzed the substance of the transaction, focusing on the guarantees, the nonrecourse nature of the underlying loan, and the offsetting payments. It concluded that these features protected Thornock from any realistic possibility of economic loss, rendering him not at risk under Section 465(b)(2) and protected against loss under Section 465(b)(4). The court emphasized that the critical inquiry is who is the obligor of last resort and that the substance of the transaction controls over its form. The court also noted that the potential bankruptcy of the guarantors was not a consideration unless it actually occurred.

Practical Implications

This decision impacts how tax professionals should analyze leveraged leasing transactions, emphasizing the need to look beyond the labels and structure to the true economic substance. It suggests that guarantees by related parties and nonrecourse financing can negate at-risk status for limited partners, limiting their ability to claim losses. Practitioners should carefully review the financial arrangements in such transactions to determine the true economic risk borne by investors. The ruling has been applied in subsequent cases, such as Moser v. Commissioner, and serves as a cautionary example for structuring tax-oriented transactions to ensure the intended tax benefits are realized.

© 2025 SCOTUSreports.com. All rights reserved.